



**FISCAL
FACT**
No. 619
Oct. 2018

Analysis of Senator Kamala Harris’s “LIFT the Middle-Class Act”

Kyle Pomerleau
Economist and Director,
Center for Quantitative Analysis

Key Findings

- Senator Kamala Harris (D-CA) announced plans to introduce legislation to create a new refundable tax credit that would be available to low- and middle-income taxpayers, called the “LIFT the Middle-Class Act.”
- The LIFT credit would reduce federal revenue by \$2.7 trillion between 2019 and 2028 on a conventional basis.
- LIFT would slightly increase the weighted average marginal tax rate on labor, leading to 825,906 fewer full-time equivalent jobs and a 0.7 percent smaller economy in the long run. Pretax wages would remain unchanged.
- The smaller projected economy over the next decade would result in slightly lower revenue collections. As a result, we estimate that this proposal would reduce federal revenue by \$2.8 trillion on a dynamic basis.
- LIFT would greatly increase the progressivity of the tax code by raising the after-tax incomes of the bottom 20 percent of taxpayers by 20.5 percent. Overall, taxpayer after-tax income would rise by 2.4 percent.

The Tax Foundation is the nation’s leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and local levels. We are a 501(c)(3) nonprofit organization.

©2018 Tax Foundation
Distributed under
Creative Commons CC-BY-NC 4.0

Editor, Rachel Shuster
Designer, Dan Carvajal

Tax Foundation
1325 G Street, NW, Suite 950
Washington, DC 20005

202.464.6200

taxfoundation.org

Introduction

Senator Kamala Harris (D-CA) announced plans to introduce legislation to create a new refundable tax credit that would be available to low- and middle-income taxpayers. Called the “LIFT the Middle-Class Act” (LIFT), this proposal would create a new \$3,000 credit (\$6,000 for married couples filing jointly). According to Sen. Harris, she introduced the credit with the goal of increasing the after-tax income of families to help address the rising cost of living.¹

Details of the Proposal

The “LIFT the Middle-Class Act” (LIFT) would create a new refundable tax credit available to low- and middle-income taxpayers.

- LIFT would provide a refundable credit that would match a maximum of \$3,000 in earned income (\$6,000 for married couples filing jointly).
- The credit would begin to phase out for single taxpayers starting at \$30,000 of adjusted gross income (AGI) and \$80,000 for single taxpayers with children, and begin phasing out for married taxpayers at \$60,000 of AGI. The phaseout rate for all taxpayers would be 15 percent.
- The credit amount and the income parameters would be adjusted each year for chained CPI-U.²
- Dependent taxpayers over the age of 18 who file tax returns would also be eligible for the credit.
- Earned income would be defined as wages, net self-employment income, and Pell Grants.
- Taxpayers would no longer be eligible for the credit if they reported more than \$3,850 in investment income. Investment income is defined as interest, dividends, net capital gains, and rental income.
- Taxpayers can choose whether to receive the benefit of the tax credit all at once during tax filing season or in equal monthly payments throughout the year.

The proposal is structured much like the Earned Income Tax Credit (EITC) in that a taxpayer must have earned income to qualify for the credit. However, it differs from the EITC in that the credit size does not depend on the number of children a taxpayer reports on their tax return.

1 Sen. Kamala D. Harris, “Harris Proposes Bold Relief for Families Amid Rising Costs of Living,” Oct. 18, 2018, <https://www.harris.senate.gov/news/press-releases/harris-proposes-bold-relief-for-families-amid-rising-costs-of-living>.

2 Most details of the proposal were confirmed by Sen. Harris’s staff. However, we were unable to confirm the measure of inflation used to adjust the credit each year.

Economic Impact

According to the Tax Foundation General Equilibrium Model, the LIFT credit would reduce the size of the economy by 0.7 percent in the long run and reduce employment by 825,906 full-time equivalent jobs. Pretax wages would remain unchanged.

TABLE 1.
Economic Impact of the LIFT the Middle-Class Act

Gross Domestic Product (GDP)	-0.7%
Wages	0%
Total Labor Compensation	-0.8%
Full-Time Equivalent Jobs	-825,906

Source: Tax Foundation General Equilibrium Model, March 2018

LIFT's impact on the economy is primarily through its effect on the labor force. LIFT phases in from the first dollar of earned income to the maximum credit of \$3,000 per tax filer. It then phases out starting at different levels of income, depending on a tax filer's marital status and whether they have children. These phase-ins and phaseouts create implicit marginal subsidies and tax rates that impact individuals' incentive to work. Individuals who currently work may alter the number of hours they work. Other individuals may enter, or leave, the labor force.

The incentives would vary based on an individual's income and their filing status. For taxpayers in the credit phaseout range, tax liability would increase by 15 cents for each additional dollar earned. This means that these taxpayers would face an additional implicit marginal tax rate of 15 percent, which would reduce these taxpayers' incentive to work additional hours.

In contrast, taxpayers in the phase-in range of the credit would get \$1 for each additional \$1 of income they earn. As such, these taxpayers would benefit from an effective marginal subsidy rate, or negative marginal tax rate, of 100 percent. A negative tax rate of 100 percent would increase the incentive for these taxpayers to work additional hours.

In addition, the fact that the LIFT credit would only be available to working individuals and couples, would encourage entrance into the labor force. Empirical evidence suggests that the EITC, a similarly structured tax credit, increased labor force participation, especially among single mothers.³

While the positive labor force effects of the phase-in of the credit could offset the negative effect of the phaseout,⁴ we find that, on net, the size of the total labor force would shrink under this policy. This is primarily due to the large number of taxpayers that would fall in the phaseout range of the credit relative to the number of individuals that would benefit from the phase-in.

3 Nada Eissa, Henrik Jacobsen Kleven, and Claus Thustrup Kreiner, "Welfare Effects of Tax Reform, and Labor Supply at the Intensive and Extensive Margins," ResearchGate.com, January 2006, https://www.researchgate.net/profile/Claus_Thustrup_Kreiner/publication/30523777_Welfare_effects_of_tax_reform_and_labor_supply_at_the_intensive_and_extensive_margins/links/0912f5098f215c61b2000000/Welfare-effects-of-tax-reform-and-labor-supply-at-the-intensive-and-extensive-margins.pdf.

4 For further discussion of our full-time equivalent job estimate, see the Methodology section.

Revenue Impact

According to the Tax Foundation Model, the LIFT the Middle-Class Act would reduce federal revenue by \$2.7 trillion between 2019 and 2028. In 2019, the LIFT credit would reduce federal revenue by \$239 billion. The cost over the decade would grow as the population grows and the size of the credit is adjusted each year for chained CPI-U. By 2028, the credit would reduce federal revenue by \$306 billion.

TABLE 2.

Revenue Impact of the LIFT the Middle-Class Act (Billions of Dollars)

Year	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019-2028
Static Revenue	-\$239	-\$246	-\$253	-\$261	-\$269	-\$276	-\$284	-\$291	-\$299	-\$306	-\$2,724
Dynamic Revenue	-\$240	-\$249	-\$258	-\$267	-\$276	-\$285	-\$294	-\$303	-\$313	-\$322	-\$2,807

Source: Tax Foundation General Equilibrium Model, March 2018

On a dynamic basis, the revenue loss would be slightly more than \$2.8 trillion over the next 10 years. Output would be lower over the budget window due to modestly higher marginal tax rates on labor, reducing payroll, corporate, income, and other tax revenue. Overall, the dynamic feedback from this proposal would result in an additional revenue loss of \$82 billion over the next decade.

Distributional Impact

The LIFT credit would greatly increase the progressivity of the federal tax code (Table 3). Taxpayers in the bottom income quintile (0% to 20%) would see the largest increase in after-tax income of 20.5 percent. Taxpayers in the next two quintiles (20% to 40% and 40% to 60%) would see an increase in after-tax income of 10.9 percent and 5.6 percent, respectively. After-tax incomes in the 4th quintile (60% to 80%) would rise by 0.5 percent. Due to the phaseout of the credit, those in the top 20 percent of taxpayers would see little to no benefit from the LIFT credit. Overall, taxpayer after-tax income would rise by 2.4 percent.

TABLE 3.
Distributional Impact of the
LIFT the Middle-Class Act

Income Quintile	Percent Change in After-Tax Income
0% to 20%	20.5%
20% to 40%	10.9%
40% to 60%	5.6%
60% to 80%	0.5%
80% to 90%	0.0%
90% to 95%	0.0%
95% to 99%	0.0%
99% to 100%	0.0%
TOTAL	2.4%

Source: Tax Foundation General Equilibrium Model, March 2018

Conclusion

Senator Kamala Harris has proposed introducing a new refundable tax credit. We estimate that the credit would reduce federal revenue by \$2.7 trillion on a conventional basis and \$2.8 trillion on a dynamic basis. It would reduce economic output by 0.7 percent and result in about 825,906 fewer full-time equivalent jobs. Overall, it would greatly increase the progressivity of the U.S. tax code, providing low-income taxpayers a large increase in after-tax income.

Methodology

We use the Tax Foundation General Equilibrium Tax Model⁵ to estimate the impact of tax policies. The model can produce both conventional and dynamic revenue estimates of tax policy. The model can also produce estimates of how policies impact measures of economic performance such as GDP, wages, employment, the capital stock, investment, consumption, saving, and the trade deficit. Lastly, it can produce estimates of how different tax policy impacts the distribution of the federal tax burden.

Typically, the Tax Foundation uses a single elasticity to estimate the impact of changes to marginal tax rates on the labor force. Due to the structure of this policy, we used two labor force elasticities: a middle- and upper-income elasticity of 0.27 and a low-income elasticity of 0.47.⁶ Consistent with the Congressional Budget Office (CBO), these labor force elasticities combine the effect of a policy on the hours worked (the intensive margin) and the decision to enter or exit the labor market (the extensive margin).⁷

The Tax Foundation model estimates the impact of a tax policy on the labor market by the change in total compensation. The change in total compensation is then converted into a full-time jobs equivalent by dividing the change in total labor compensation by the average wage rate. Since this policy impacted two groups of individuals at different income levels—low-income individuals facing the phase-in of the credit and individuals facing the phaseout of the credit—our total jobs estimate is the sum of the full-time jobs' effect of the two groups of taxpayers.

For taxpayers in the phaseout, the credit would raise marginal tax rates. This increase in marginal tax rates, in isolation, would result in a reduction of labor supply equal to \$73 billion in labor compensation or 0.84 percent. We then estimate that average labor compensation for individuals impacted by the phaseout is approximately \$81,000 a year. A \$73 billion drop in total labor compensation divided by \$81,000 equals a reduction of 1.04 million full-time equivalent jobs due to the phaseout of the credit.

For taxpayers in the phase-in, the credit would reduce marginal tax rates. The lower marginal tax rate would increase total compensation by \$3.3 billion. For taxpayers in the phase-in range, we assume that their annual income is about \$15,000, which approximates annual compensation for someone employed full-time at minimum wage. Thus, \$3.3 billion divided by an average annual income of \$15,000 nets an increase in full-time equivalent jobs of 221,414.

5 Stephen J. Entin, Huaqun Li, and Kyle Pomerleau, "Overview of the Tax Foundation's General Equilibrium Model: April 2018 Update," Tax Foundation, https://files.taxfoundation.org/20180419195810/TaxFoundaton_General-Equilibrium-Model-Overview1.pdf.

6 We use CBO's high-end elasticity for low-income taxpayers. We think this is appropriate given the evidence that the labor force participation effect can be strong. See Edward Harris, and Shannon Mok, "How CBO Estimates the Effects of the Affordable Care Act on the Labor Market," Congressional Budget Office, December 2015, <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/workingpaper/51065-acalabormarketeffectswp.pdf>.

7 Ibid.

Policy Assumptions

Details of the “LIFT the Middle-Class Act” were provided by Senator Kamala Harris’s staff. The ultimate impact of the proposal on revenue, the economy, and the distribution of the tax burden will depend on its final details. At the time of publishing the analysis we were unable to confirm the measure of inflation that the credit would be adjusted for inflation each year. We assumed that the credit and the parameters would be adjusted for chained CPI-U, the same measure of inflation used to adjust other parameters in the tax code. A different measure of inflation could either increase or decrease the cost of the proposal. We also assumed that married couples filing separately would not be eligible for the credit, consistent with the EITC.

The economic impact of the new credit depends on the responsiveness of individuals to marginal tax rates. If taxpayers react by reducing hours worked by more (or less) than we assume then the drop in economic output would be larger (or smaller) than we estimated. Likewise, if individuals react more strongly to the increased incentive to enter the labor force, output would drop by less than we estimate.

Other models assume that there is a limited amount of saving available to the United States and that when the federal budget deficit increases, the amount of available saving for private investment is “crowded out” by government borrowing, which reduces the long-run size of the U.S. economy. While past empirical work has found evidence of crowd-out, the estimated impact is usually small. Furthermore, global savings remains high, which may explain why interest rates remain low despite rising budget deficits. We assume that deficit increase will not meaningfully crowd out private investment in the United States.